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SENSITIVE

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SUBJECT: Melbourne Businesses See Tough Times Ahead

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Summary

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11. (SBU) Melbourne business leaders predict that Australian GDP growth will slow to approximately two percent in the coming three quarters. While most are not using the word recession, there is an expectation that jobs will be lost, commodity prices will fall and belts will have to be tightened. The jury is still out on how effective PM Rudd's recent financial rescue plan will be (reftel), and analysts are similarly divided on how hard a landing commodities will have. With Australians concerned about slowing global growth, the slowing domestic economy, the plummeting value of their retirement funds and the possibility of protectionist policies springing up in the United States the global financial crisis certainly appears to have hit home in Melbourne. End Summary.

The "R" Word

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12. (SBU) During a series of meetings with Melbourne business leaders and analysts on October 22, most contacts told visiting Econcouns that they expect Australian GDP growth to slow to approximately two percent in late 2008 and early 2009 but do not anticipate a recession. Only Goldman Sachs/JB Were Chief Economist Tim Toohey stated that his firm expects a recession in Australia. Toohey attributed this to "dramatic wealth destruction, debilitating tightness in money markets, rapidly slowing credit growth, sharp falls in commodity prices and the increasing probability that Australian house prices are now in decline."

13. (SBU) National Australia Bank's (NAB) Head of International Economics, Tom Taylor forecast a "grim" outlook for early 2009 due to a loss of confidence in global financial markets. In addition to supply problems with obtaining credit, Taylor noted that "deposits are pouring in," indicating that NAB customers are taking a more defensive stance and are becoming more adverse to seeking credit. Victoria's Secretary of the Treasury, Grant Hehir indicated that he expected Victoria's jobless rates to increase to five percent. According to Hehir, there has been an "enormous drop off" in tax revenue particularly in conveyances and housing. During the Asian Financial Crisis, Australia was able to export to the United States and in the aftermath of the dot com bubble, Australia looked to Asia; now "there is nowhere to go."

14. (SBU) Tony Pensabene of the Australian Industry Group (AIG) described a general slowing of the economy except in the commodities and infrastructure sectors. Most of AIG's members, Pensabene said, say that things are getting "tough." While some members complain of year-on-year losses of up to 16 percent, AIG believes that the

Australian economy will continue to grow, albeit at a reduced clip. Analysts at AIG, NAB and Goldman Sachs/JB Were agreed, however, that trouble in the global financial sector has begun to spill over into the "real" Australian economy.

#### Reaction to Rudd's "Rescue Plan"

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15. (SBU) Both Toohey and Taylor stated that Prime Minister Rudd's financial "rescue" package would likely be too little, too late. According to Toohey, "the lags between policy implementation and the impact upon the real economy will likely be too late to avoid a shallow recession and draw an end to Australia's record 17 year economic expansion." Expressing a similar sentiment, Tom Taylor said that Rudd's package would not be enough to avert a turbulent first quarter in 2009 and said that quick spending on infrastructure would not be sufficient to reverse impending job losses. Taylor believes that the benefits of the plan will be exhausted by Christmas.

#### Boom, Bust?

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16. (SBU) Melbourne observers maintain different expectations about the future of Australia's commodities sector. NAB Economist Tom Taylor believes that Australia's economy is historically driven by strong foreign investment as well as a robust export market. Citing a series of similar downturns in the late 19th and early 20th centuries, Taylor believes that there is no "soft landing" in store for Australia's commodities market. Goldman Sachs/JB Were economists take a different stance and believe that rates of growth in China will be "modestly" slower in 2008/2009, but that China will continue to drive rising global raw materials demand. Goldman analysts say that the slowdown in Chinese construction will be "very

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localized and will predominantly affect Shanghai and a few other East Coast cities." Victoria's Secretary of the Treasury said that commodity prices have fallen in Australia, but the impact on Victoria will be less pronounced than in the resource rich states of South and West Australia.

#### Fear of U.S. Protectionism

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17. (SBU) Australians from all quarters are expressing fear of increased U.S. trade barriers. Many believe that in addition to heightened regulatory pressure on financial institutions, Americans will retreat to a more protectionist trade stance. Victorians are concerned that a strong protectionist stance by the United States will encourage similar closed doors among other global economies. Econcouns emphasized that revived trade barriers are not part of the U.S. response to the global financial crisis.

#### Comment

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18. (SBU) While there is no consensus on where the Australian economy is heading, most expect a period of slower growth. This slowdown, arguably unlike previous ones, has had a significant psychological impact on many Australians due to mandatory superannuation (retirement fund) contributions and the perception that "vast" amounts of wealth have disappeared. Although it may still be too soon to tell exactly how the global financial crisis will affect Australia, very few believe that they will remain immune from the international economic malaise. Most contacts still believe that Australia will fare better than other Western economies, but are wondering to what extent the crisis will impact their lives.

THURSTON